APPENDIX

[Letterhead]

May 24, 1978

Anne P. Jones, Esquire
General Counsel
Federal Home Loan Bank Board
1700 G. Street, NW
Washington, DC 20552

Dear Ms. Jones:

This letter is in response to your request for my opinion on the meaning and effect of the choice of law provision contained in Uniform Covenant 15 of the FNMA/FHLMC Single-Family Mortgage Instruments, particularly as that provision affects the inter-relationship of federal and state law. Uniform Covenant 15, which is found in each state home mortgage instrument, provides:

> "This form of mortgage combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property. This Mortgage shall be governed by the law of the jurisdiction in which the Property is located. In the event that any provision or clause of this Mortgage or the Note conflicts with applicable law, such conflict shall not affect other provisions of this Mortgage or the Note which can be given effect without the conflicting provision, and to this end the provisions of the Mortgage and the Note are declared to be severable."

This letter will analyze the meaning of Uniform Covenant 15 in terms of the history of its drafting, the effect of federal supremacy and the intent of the parties reflected by the mortgage.

The Drafting History:

Initially, I believe a brief explanation of the history of the uniform mortgage instruments would be helpful. When the Emergency Home Finance Act of 1970, 12 U.S.C. §1451, created The Mortgage Corporation ("FHLMC") and authorized the Federal National Mortgage Association ("FNMA") to purchase conventional home mortgages, FHLMC and FNMA undertook jointly to prepare their own conventional mortgage documents. The Congressional hearings which led to the federal sponsorship of a secondary market for conventional mortgages had emphasized the need to standardize the terms of home mortgages in order to facilitate their acceptability as investments in a national market. Accordingly, the two Corporations endeavored to prepare forms that would provide a maximum degree of national uniformity.

We felt our forms would benefit from a standard choice of law provision to help reach our goal of maximum substantive uniformity. The choice of law sentence was included in Uniform Covenant 15 to state a ruler of choice for potentially competing state laws; issues of this type were anticipated, and these could not always be resolved by drafting. The choice of law sentence in Uniform Covenant 15 of the mortgage was not intended to state a choice of state as opposed to federal law.

In fact, we understood that federal law was generally applicable to a loan originated on the FNMA/FHLMC forms if the lender was a federally chartered institution and that this was mandated by the federal law itself. Pursuant to the Congressionally delegated authority to "make policy", the Federal Home Loan Bank Board has promulgated "comprehensive" regulations which, the courts have uniformly and consistently held, govern every aspect of the operations

of every federal savings and loan association from its birth to its death. *People v. Coast Federal Savings & Loan Association, supra,* 98 F. Supp. 311 (S.D. Cal. 1951); *Kupiec v. Republic Federal Savings & Loan Association,* 512, F. 2d 147, 150 (7th Cir. 1975). As you know, the rationale of the *Coast Federal* case was adopted by the Ninth circuit in *Meyers v. Beverly Hills Federal Savings & Loan Association,* 499 F. 2d 1145 (9th Cir. 1974). At issue in *Meyers* was whether a Board regulation on the terms of mortgage loans made by federal associations so occupied the field as to exempt federal associations in California from state law dealing with prepayment penalties. The Ninth Circuit held flatly and unequivocally that in an area regulated by the Board "federal law preempts the field" so that "any California law in the area is inapplicable to federal savings and loan associations operating within California" (499 F. 2d at 1147).

However, even lenders governed by federal law may be concerned about specifying a choice between potentially applicable state laws because governing federal law may require compliance with state rules. An example of the need to choose among competing state laws can be seen in a current example involving home mortgage transactions which arguably are subject to the law of two states. Today certain Maryland lenders, even those which are federally chartered, lending to Virginia residents on Virginia property could be said to be required to pay interest on a mortgage escrow account maintained in connection with that loan because of a Maryland statute requiring interest to be paid on escrow accounts. State lenders are directly subject to this law; federally chartered associations must comply with this particular state law pursuant to FHLBB Reg. §545.6-11(c). (This requires federally chartered associations to pay interest on escrow accounts if state chartered lenders must, although

not necessarily at the rate required by state law.) I understand that Maryland lenders, state and federal, using the FNMA/FHLMC Mortgage have taken the position that Maryland law does not apply to such loans, in part because of the Uniform Covenant 15 choice of law provision.

Another example of the need for Uniform Covenant 15 in order to choose among competing state laws arises under the Uniform Probate Code. The general common law rules is that the rights of survivors in a decedent's real property situated in a state other than the state of the decedent's domicile are to be determined in accordance with the law of the jurisdiction in which the realty is situated. However, the Uniform Probate Code overrules this common law principle and provides that the law of the decedent's domicile governs a surviving spouse's rights in real property located in another state. The effect of this may be that a waiver of dower, which would be enforceable in the jurisdiction in which the property is located and the mortgage is taken, would be unenforceable because of the application of the law of the decedent's domiciliary state. Uniform Covenant 15's choice of law provision should preserve the enforceability of the dower waiver by directing the domiciliary state court to apply the law of the state in which the property is located and thereby uphold the waiver.

Lenders, consumers, and their lawyers who commented in 1970 and 1971 on the exposure draft version of the mortgage instruments circulated nationally by FNMA and FHLMC understood that the purpose of Uniform Covenant 15 was to choose among competing state laws. Most persons commenting on the substance of the choice of law provision in Uniform Covenant 15 focused on the fact that the provision referred only to the "Mortgage" and not to both the

"Mortgage" and the "Note". None of the commentators suggested that the clause in any way went beyond stating a choice between competing state laws.

Federal Supremacy:

I would like to make some observations about the effect of Uniform Covenant 15 with regard to the litigation involving the enforceability of due-on-sale clauses under the state law and the federal preemption issue. State law necessarily includes federal law to the extent to which the federal Constitution provides for federal supremacy and the federal government has acted within its authority. Thus, a provision which states that the law governing the contract is "the law of the jurisdiction in which the property is located" does not exclude federal law. Federal law necessarily is a part of the law of that jurisdiction. For this reason, a choice of law provision such as Uniform Covenant 15 provides no basis to find an intent on the part of the contracting parties to choose between state and federal law or to disavow the application of any federal law or regulation that might apply to that contract.

The Intent of the Parties:

I believe that consideration of the parties' contractual intent is important because of the substance of the Board's regulation on "due-on-sale" clauses such as Uniform Covenant 17 of the FNMA/FHLMC Mortgage. As you know, the Federal Home Loan Bank Board's due-on-sale regulation does not require federally chartered savings and loan associations to obtain the right to accelerate on sale. Rather, the regulation states that if a federal association does contract for this right, the contract provision shall be enforceable. Therefore, the question that would arise if the choice of law provision in Uniform Covenant 15 were deemed relevant in a dispute over the enforceability of Uniform Covenant

17 would be whether the parties to the mortgage intended to disavow the application of the sanctioning federal regulation. That question must be answered from the specifics on the contract.

For the reason I have just suggested, I do not believe it is possible to infer such an intent on the basis of the choice of law sentence in Covenant 15. To the contrary, it seems to me that the sentence states no choice at all as between federal and state law. Therefore, if there is a question as to whether the parties contracted for a due-on-sale provision, other provisions of the contract must be examined. Such an examination reveals that the FNMA/FHLMC Mortgage contains an express provision on this point which establishes the parties' intent to create an enforceable due-on-sale provision. This is reflected in Uniform Covenant 17 (which, in the case of California, is repeated in the Note as well).

It is a basic rule of contract interpretation that a specific provision will control over a more general provision. *Restatement, Contracts,* §236(c); *Corbin on Contracts* One Volume Edition §§545-554; 17 Am. Jur. 2d *Contracts* §270. This concept is reflected in the *Restatement Second, Conflict of Laws* by the rule that a choice of law provision will not be applied to invalidate a term of contract which would be valid under other applicable law. *Restatement Second, Conflict of Laws* §187, Comment (e); accord; *Kossick v. United Fruit Co.*, 365 U.S. 731, 741 (1961); *Pritchard v. Norton,* 106 U.S. 124, 137 (1882). Thus, given the express contractual provision of Uniform Covenant 17, conferring the right to accelerate on sale, it is most implausible to argue that the parties did not intend this provision to be an enforceable term of their contract.

Conclusion:

Based on the foregoing, it is my conclusion that neither the drafting history of the FNMA/FHLMC forms, the relationship of federal and state law nor the intent of the parties to the loan can reasonably be understood to state a choice between federal and state law. Federal law preempts state law for federally chartered associations unless state law is chosen by the federal rule, and nothing in Uniform Covenant 15 changes this. Moreover, a court seeking to give effect to the choice of law sentence must consider applicable federal law as a part of the law of the jurisdiction in which the mortgaged property is located. If, for example, federal law expressly gives the parties to the mortgage an option to choose a particular term of the mortgage, state law on the enforceability of that term provision is, for loans governed by federal law, immaterial. The only question would be whether the parties had exercised their option under federal law. That question must be answered by the specifics of the contract, *e.g.* whether their contract contains the provision and whether the provision is in a form which complies with the federal regulations. If these tests are met, such an express term of the contract should not be invalidated on the basis of an implication sought to be drawn from a general provision of the contract.

If I can provide further information or assistance to you, I will be pleased to do so.

Sincerely,

/s/ Henry L. Judy
Henry L. Judy
[Vice President and General Counsel,
Federal Home Loan Mortgage Corporation]

HLJ:kms

cc: James E. Murray,
Senior Vice President and General Counsel,
Federal National Mortgage Association